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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20511

Re: Proposed Changes to Closed-End Mortgage Rules (Docket No. R-1366)

Dear Ms. Johnson and Governors:

Thank you for the opportunity to comment on the proposed rule amending Regulation Z with respect to closed-end mortgages. I am an adjunct professor teaching real estate finance for the local community college as well as a loan originator working in North Texas. Having witnessed first-hand the mortgage problems of the last three years, I can see that some additional consumer information is needed so that consumers can take personal responsibility for their actions while significant changes in the secondary markets are also needed. However, I have some concerns with the proposals regarding loan originator compensation since they, in and of themselves, will not directly address the problems of the subprime market and could cause major unintended consequences in both the finance and the real estate markets.

First, you can't fix a problem that was primarily created by Wall Street firms to spur the sale and delivery of higher risk loans by clamping down on everyday compensation to the current employees who are working to help borrowers today. The rogue secondary market has disappeared – and because of the losses, will never return (at least not in our lifetimes). If you react to the old system by damaging the current system, you will exacerbate an already weak real estate economy. Many of the subprime lenders had only subprime products for their originators to offer so they sold subprime loans instead of FHA. Similarly, if Toyota builds an inferior car after years of building great cars, the Toyota car salesman will sell Toyotas and not Chevrolets that he doesn't have in the showroom. Chevrolet salespeople should not be penalized by removing discretion in the prices and profits of the dealership, not to mention their commissions for delivering sales that are more profitable to the Chevrolet dealership, considering educated consumers are the buyers. If the Toyotas are subsequently recalled as unsafe, do you penalize the dealership and the salespeople because they sold a lot of Toyotas by saying that future car sales will not be allowed to have commission-based compensation? The Wall Street firms were the car manufacturers who were trusted for building dependable cars; the dealerships were the mortgage companies who sold the products that they were told were safe for consumers; the salesmen were compensated for selling what regulators allowed to be sold and what they were told were safe. If you make the salespeople salaried functionaries, do you stop Toyota from building unsafe cars that regulators didn't tell them not to sell? No, of course not. People simply stop buying the bad cars and start buying the safer cars, forcing the bad car builder out of the market if it doesn't stop building inferior cars. Are you aware that the lenders no longer offer higher yields on mortgage products that are not plain vanilla (partly because they no longer even offer the risky products)? The market has corrected the problem without any further regulation needed.

Furthermore, from time immemorial, people have been expected to negotiate their purchase prices on everything from vegetables, to cattle, to real estate prices, to rates on loans. If the price is too dear, they find another vendor. If the consumer buys a bad apple, he doesn't expect the Federal Reserve to make apple vendors stop earning commissions on their apple sales; he stops buying those apples from that vendor. Are people buying mortgages from Lehman Brothers anymore? It's a market solution that has already taken place with no need for further regulation.

Second, every borrower has a different personal situation. Many applications require real expertise and time-consuming efforts that call-center and bank-teller originators cannot adequately address. The high quality loan consultants are compensated based on their ability to bring loans into the company by getting referrals from past clients, Realtors, builders, CPAs, etc., as well as their ability to convince prospects to let them handle the transaction once it is referred to them. This is sales and marketing layered on top of knowledge and expertise. They are compensated based on their ability to bring a quantity of quality loans, including bringing those loans that must be handled expertly – at a profit to the company. Just as the best salespeople in every other industry in this great country are compensated for the profitability of the business they bring to their companies, loan consultants that do so for mortgage companies are properly compensated similarly. The best of them earn more because they perform with higher expertise, working harder and longer than the less-compensated, with higher profit they can generate for the company without losing the sale because of competitive pressures, and their earnings cannot be paid as a salary if the company expects to keep them. Unless you are going to become fascist or socialist and outlaw variable compensation for every salesperson in the United States, they will simply leave to go to an industry that hasn't been perverted by over-regulation. Competitive pressures eliminate the need for more regulation if you let them.

The interesting thing that has been overlooked in the discussions I have studied is that the new Good Faith Estimate that will be required next month coupled with the elimination of the subprime industry have not yet been allowed to bear fruit. The current prime loan delinquency rate shows that sometimes people simply must be foreclosed, even if it's not politically expedient. Bankers know that some people don't pay them back. The prime borrowers were allowed to shop for the best rate yet their houses are increasingly delinquent. Show me a study that removes all other factors and proves that the people who negotiated the lowest rate on a prime mortgage were less likely to be foreclosed than those who negotiated a higher rate on a prime mortgage (there is no such study as far as I know). Middle easterners are much more adept at negotiating than many Europeans, yet the middle easterners are the minority in the U.S. and there is no proof that the fact that their lenders allowed negotiated rates and variable compensation had any impact on the performance of their loans. The point is that one can be fair without being equal and our current leadership is confusing the two. Fair means everyone has an equal opportunity; equal means that everyone gets the same thing whether deserved, earned or entitled without justification. You can't expect that eliminating merit- and profitability-based compensation models will act like a laser and stop people from making poor purchase and loan decisions. Current mortgage regulations need time to work before creating new, misdirected compensation-based regulations.

Third, not all loans and borrowers are equal in complexity. If the proposed rule prohibits mortgage companies from paying adequate compensation to creative and highly impactful loan consultants, the originators will act as humans do and will be less inclined to take on the more complex, the less compensated, the more time consuming loans, if they remain in the industry at all. Instead, those consultants who haven't fled the industry will focus primarily on the straight-forward, conventional loan applications that are less time consuming. The unfortunate consequence of this change in focus will be to make it even harder for many deserving consumers to obtain a mortgage loan, particularly those in underserved communities, small business owners, commissioned salespeople (if we don't regulate away all compensation that is commission-based in the United States), credit-challenged and those people who seek professional guidance. The end result over time is that the huge national lenders with track records of proving little to no personal service (you know who the big national servicers are and their reputation right now for terrible service), who would profit from not having to pay higher compensation, will take the business from all of the middle and small companies that offer a high level of service and compensate their consultants appropriately for bringing profitable business – and once the consultants leave the industry, the origination will go oversees to call centers in India, causing the U.S. to lose even more jobs in the process. This isn't an idle speculation. It has happened in service businesses all over this great country whenever the service that is provided takes little or no personal expertise, so if you drive out the consultants with expertise, that's all you will have left. How will Realtors and builders function if they can't get efficient and timely closings because the true experts have left for appropriately compensated commission jobs in other industries that aren't crushed by regulators? You could very well have the unintended consequence of regulating all your expertise right out of the business. I can tell you that all of the top producers I know will leave the industry as soon as they can find a way out if you prohibit fair compensation by regulation.

Fourth, the new SAFE Act requirements for loan originators, including extensive background checks, education and rigorous testing requirements will eliminate the bad actors that might somehow still be working in the industry and whose poor track record precipitated this proposal.

Finally, if the Board disregards the changes in the secondary markets and doesn't allow for the changes already imposed but not yet showing fruit, and adopts the proposed restrictions on loan originator compensation, the limits should apply only to the extremely risky products that were at the heart of the subprime and/or option ARM meltdowns. Because conventional prime loans do not create any potential for abuse, the Board should exclude these loans from the restrictions on loan originator compensation and allow for pricing and compensation discretion in these loans. To do otherwise is to single out the salespeople of loan products as the sole demons in society, while legal, car, insurance, accounting and every other industry's purveyors are allowed to continue to have discretion to compensate based on profits of the sale. And everyone knows that lawyers and car salesmen have much less respect for being honest and having integrity than bankers, even after the real estate slowdown.

However, this should only be a worst-case solution. In reality, based on facts behind the problems we suffered in the real estate industry, the Board should wait to allow the new Good Faith Estimate, the new pricing models that the low-risk secondary market offers, fair market forces, and the SAFE Act a chance to work before piling on additional and burdensome regulations on compensation that will invariably kill any semblance of an American lending environment.

Once again, thank you for the opportunity to comment on the proposed rule.

Respectfully submitted,

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